

Actuaries Summit

Think Differently



**Actuaries
Institute**

21-23 May 2017 • Grand Hyatt Melbourne





Group Insurance – Structures of the Future

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Structures of the Future

- Focused on
 - Customer – trustees representing members of superannuation funds
 - Large Not For Profit Funds
- Thinking differently - Is there a problem?
- Thinking differently – what are the alternatives?

Structures of the Future

- Thinking differently - Is there a problem?
 - Current structure
 - Is there Stability, Efficiency, Competition?
 - Mismatch Risk
 - Risk transfer, the real risk premium and the costs of recycling money
 - Large funds are self insured
 - Where do the life policy services best sit
 - Other insurance markets



Structures of the Future

- Thinking differently – what are the alternatives?
 - Claims Management
 - Alternatives using current industry structures
 - Alternatives introducing new structures



Thinking differently - Is there a problem?

- Current structure
 - Provided \$5.3bn in payments in 2016 to superannuation funds
 - Predominantly to members who are retiring from the workforce
 - Unexpected
 - Lower net financial wealth
 - Financial dependants
 - Poor safety net



Thinking differently - Is there a problem?

- Current structure
 - Insured
 - single insurer, insuring all of the claims cost;
 - possibly supported by a single reinsurer;
 - claims determined by the insurer with oversight from the trustee.



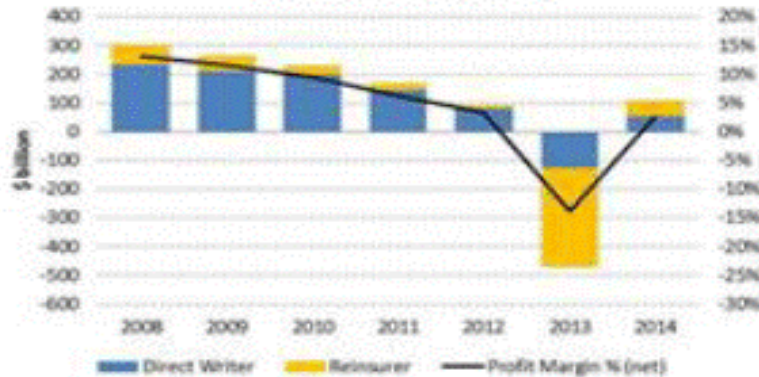
Thinking differently - Is there a problem?

- Stable, Efficient, Competitive
 - How has the industry performed?

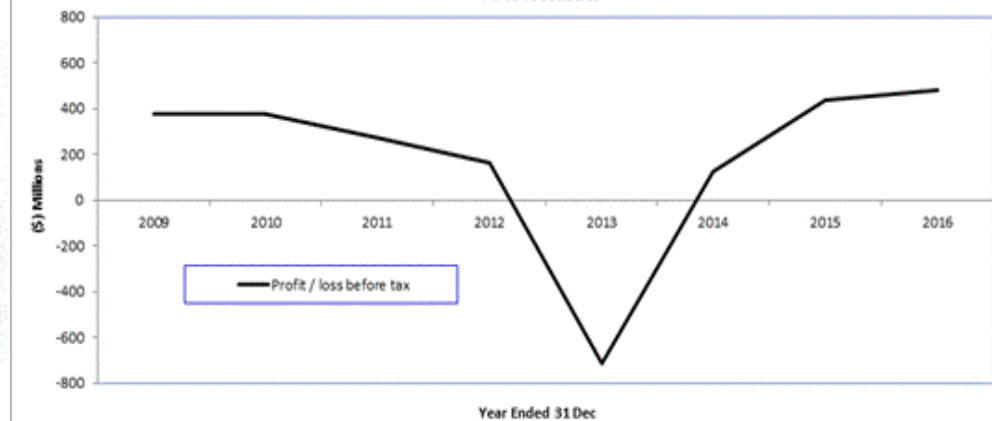
Stability



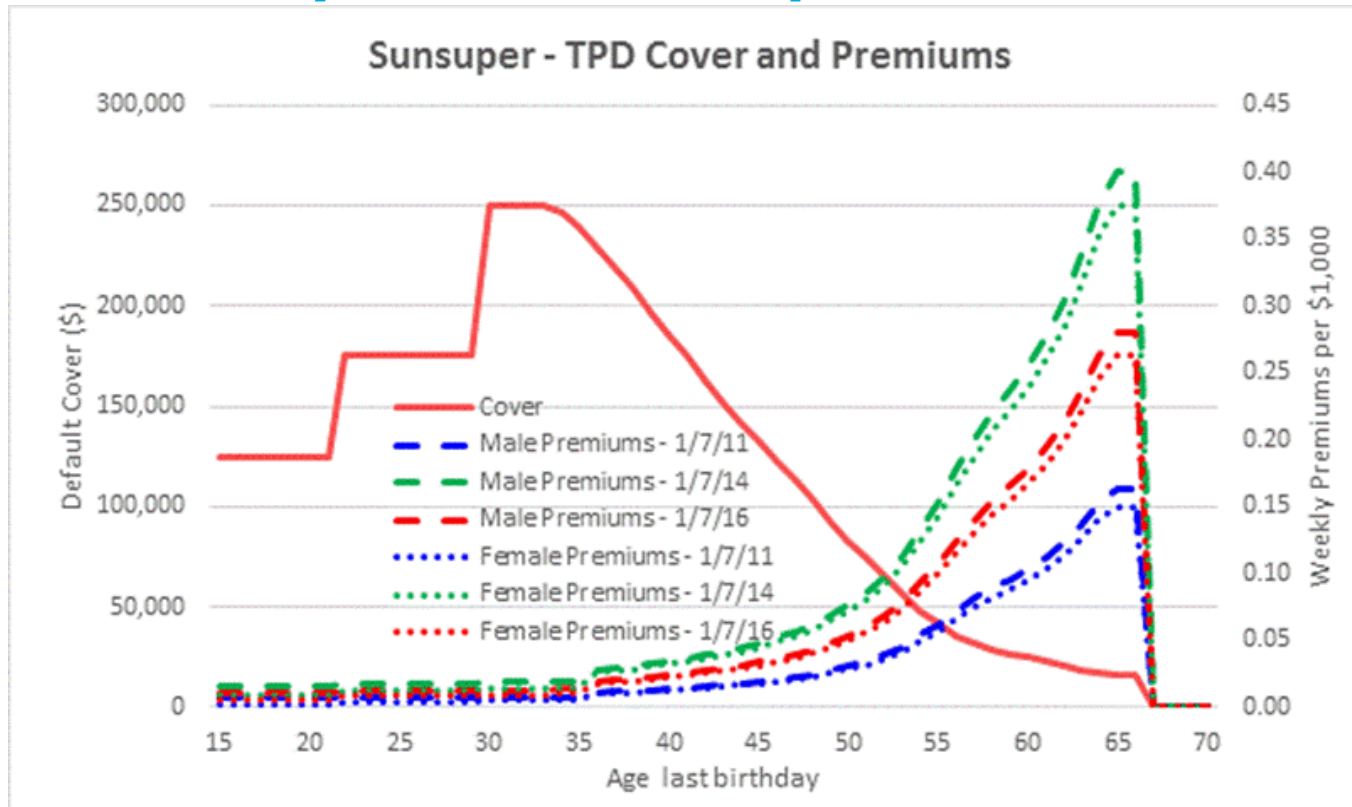
**Cedant & Reinsurer Annual Net Profits
- Group Death/TPD -**



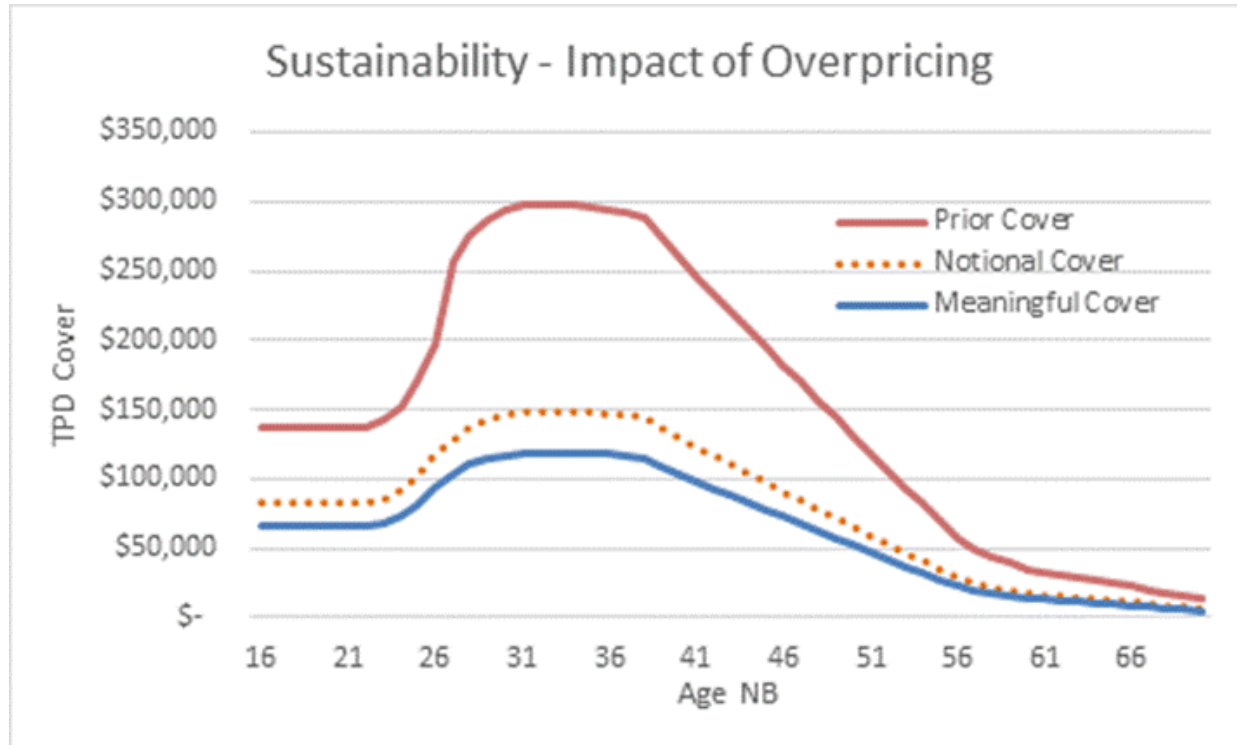
**Group Insurance - Superannuation Business Profit / loss before tax
APRA Statistics**



Stability- Premium up 146%, down 30%



Stability – TPD Premium up 172%, Cover Lapsed





Efficiency

- Market efficiency
- Benefit Efficiency

Efficiency

- Market Efficiency
 - Many willing buyers - Yes but falling
 - Many willing sellers – Insurer oligopoly and will not change, possibly for reinsurers
 - Readily discoverable long term price – improving
 - No or few barriers to entry – fail at all levels

Efficiency

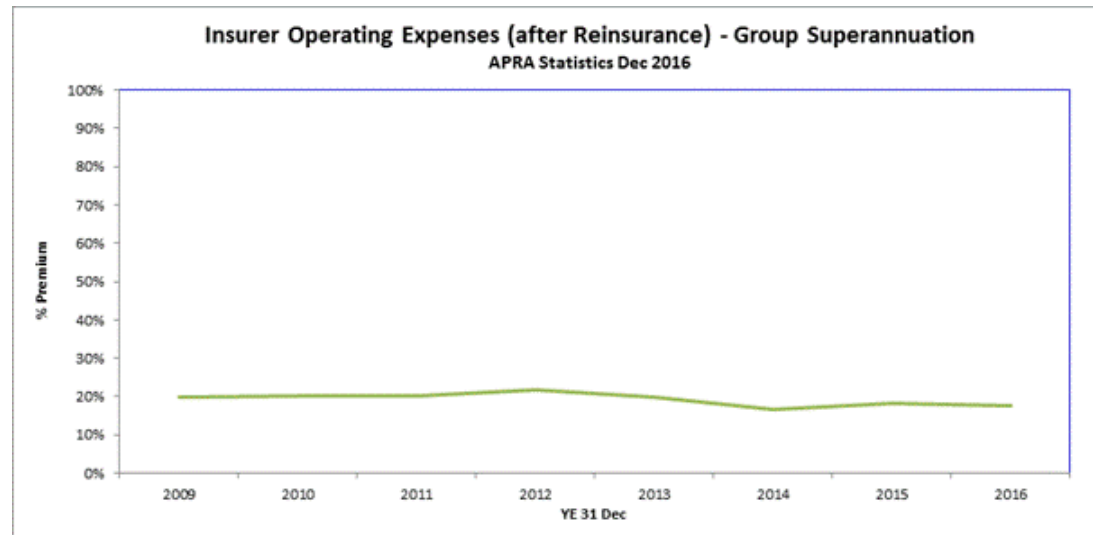
- Benefit Efficiency
 - FSI terminology defining a leakage concept in a pooled risk sharing arrangement in this case for retirement income
 - Can be extended to any risk share pool such as insurance of death and disability cover
 - How much of the money that goes into the pool is returned as benefit

Efficiency

- Benefit Efficiency
 - 73% for insurers
 - plus for reinsurers
 - minus for fund admin margin
 - Cannot be measured for market as a whole using APRA stats
 - Appears low e.g. against health with 84% which is individual business

Efficiency

- Operational expenses
 - Stuck at 20% of premium despite massive premium growth



Efficiency

- Operational expenses
 - No economies of scale evident
 - Life and Super are compliance dominated industries with high cost base.
 - More coming



Thinking differently - Is there a problem?

- Stable, Efficient, Competitive?
 - Not even a low Pass
 - on any criteria
 - possibly reinsurance on efficiency and competition
 - Will not consistently Pass in the future
 - Without change nothing will change

Mismatch risk

- Trustee makes long term commitments under legislation and to members
- But forced to cover these commitments using a structure that offers:
 - only short term guarantees
 - barriers to change
 - short term relationships e.g.
 - 2013 to 2015 market failure
 - Retrospective pricing

The Real Risk Premium

- Real risk premium – risk transfer
 - Insurance is a “risk-transfer mechanism that ensures full or partial financial compensation for the loss or damage caused by event(s) beyond the control of the insured party”
 - Insured party = trustee not the member
 - For large funds risk transfer premium = 5% to 15% of the current premium
 - Balance of traditional Risk Premium is recycled claims and rebates

The Real Risk Premium

You should only insure what you cannot afford to replace

- Recycled money is not frictionless
 - Each party that handles the money clips the ticket
 - Stamp duty
 - Easier to hide inefficiency in a big number than a small number

Large Funds are Self-Insured

- Self-insurance occurs when the consumer meets the cost of their own claims
- Medium term
- Even short term
 - Barriers allow clawback
 - Recent experience
- Risk for trustee who does not control the claims process

Large Funds are Self-Insured

- Practice of insurers in finding trends and feeding these into future price diminishes the financial incentive to properly manage claims
- Lack of alignment of who pays for claims management cost and who pays for claims
- Large funds are effectively self insured with short term stop loss

Who Can Provide the Service

- Services provided by a life policy
- Where do these best sit for optimal delivery of benefits?
- Every one of these could sit with the fund if it is large
- The answer will not necessarily be the same for each trustee



Who Can Provide the Service

Assessment Criteria	QInsure	Ins 1	Ins 2
Risk assessment – capital ratio, takeover terms and client conflicts	✓		
Product features and conditions	✓		
Proposed service approach			✓
Underwriting Management capability		✓	✓
Claims Management capability	✓		
Pricing and associated terms	✓		
OVERALL ASSESSMENT	✓		



Other Industries

- General Insurance
 - Market efficiency more prevalent
 - Multiple insurers on a single policy
 - Self insurance for companies of their statutory death and disability benefits even for low grade companies
- Health Insurance
 - High Benefit Efficiency at 84%
 - Market efficiency more prevalent
 - Self insurance by a large mutual sector

Claims Management

- Optimise
 - Service and “member experience”
 - Culture, particularly RTW
 - Alignment of financial interest

Alternative Structures

The future is already here — it's just not very evenly distributed

- How are we to judge the alternatives against the current approach?
- Could use the APRA Benchmark
 - The structure ensures financial promises are met in all reasonable circumstances

Alternative Structures

- Improved delivery of benefits may come from:
 - reducing the risks faced by trustees and ultimately members
 - reducing volatility in premiums
 - increasing efficiency which will reduce premiums
 - improving the so called “member experience”

Alternative Structures

- Alternatives that modify current structures
 1. Multiple reinsurers
 2. Premium Adjustment models
 3. Agreed Margin models
 - 4. Stop Loss Cover** – use an appropriate excess
 5. Separate Statutory fund
 - 6. Life licence**
- Alternatives that introduce structures not currently used
 1. Derivatives
 - 2. Self-insurance**
 - 3. Pooling**



Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures					
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence
Mismatch Risk	3						
Market Failure	3						
Benefit Efficiency	3						
Risk transfer - Friction of recycled premium	3						
Simplicity	1						
Lock In - inability to change	3						
Cultural Fit with Trustee	3						
Claims Management Improvements	3						
Master of own destiny	3						



Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures					
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence
Mismatch Risk	3	2					
Market Failure	3	2					
Benefit Efficiency	3						
Risk transfer - Friction of recycled premium	3						
Simplicity	1	2					
Lock In - inability to change	3	2					
Cultural Fit with Trustee	3						
Claims Management Improvements	3						
Master of own destiny	3	2					



Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures					
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence
Mismatch Risk	3	2					
Market Failure	3	2	1				
Benefit Efficiency	3		2				
Risk transfer - Friction of recycled premium	3						
Simplicity	1	2	2				
Lock In - inability to change	3	2					
Cultural Fit with Trustee	3						
Claims Management Improvements	3						
Master of own destiny	3	2	2				



Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures					
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence
Mismatch Risk	3	2					
Market Failure	3	2	1	2			
Benefit Efficiency	3		2	2			
Risk transfer - Friction of recycled premium	3						
Simplicity	1	2	2				
Lock In - inability to change	3	2					
Cultural Fit with Trustee	3			2			
Claims Management Improvements	3			2			
Master of own destiny	3	2	2	2			



Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures					
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence
Mismatch Risk	3	2					
Market Failure	3	2	1	2			
Benefit Efficiency	3		2	2	1		
Risk transfer - Friction of recycled premium	3				1		
Simplicity	1	2	2		2		
Lock In - inability to change	3	2			2		
Cultural Fit with Trustee	3			2			
Claims Management Improvements	3			2			
Master of own destiny	3	2	2	2			



Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures					
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence
Mismatch Risk	3	2				2	
Market Failure	3	2	1	2		2	
Benefit Efficiency	3		2	2	1	2	
Risk transfer - Friction of recycled premium	3				1		
Simplicity	1	2	2		2		
Lock In - inability to change	3	2			2		
Cultural Fit with Trustee	3			2		2	
Claims Management Improvements	3			2		2	
Master of own destiny	3	2	2	2		2	

Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures					
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence
Mismatch Risk	3	2				2	1
Market Failure	3	2	1	2		2	1
Benefit Efficiency	3		2	2	1	2	2
Risk transfer - Friction of recycled premium	3				1		2
Simplicity	1	2	2		2		
Lock In - inability to change	3	2			2		1
Cultural Fit with Trustee	3			2		2	1
Claims Management Improvements	3			2		2	1
Master of own destiny	3	2	2	2		2	1

Alternative Structures

Attribute	Typical Current	Alternatives that introduce structures not currently used		
		Derivatives	Self Insurance	Pooling
Mismatch Risk	3	2		
Market Failure	3	1		
Benefit Efficiency	3	2		
Risk transfer - Friction of recycled premium	3			
Simplicity	1	3		
Lock In - inability to change	3	2		
Cultural Fit with Trustee	3			
Claims Management Improvements	3			
Master of own destiny	3	2		

Alternative Structures

Attribute	Typical Current	Alternatives that introduce structures not currently used		
		Derivatives	Self Insurance	Pooling
Mismatch Risk	3	2	1	
Market Failure	3	1	1	
Benefit Efficiency	3	2	1	
Risk transfer - Friction of recycled premium	3		1	
Simplicity	1	3		
Lock In - inability to change	3	2	1	
Cultural Fit with Trustee	3		1	
Claims Management Improvements	3		1	
Master of own destiny	3	2	1	

Alternative Structures

Attribute	Typical Current	Alternatives that introduce structures not currently used		
		Derivatives	Self Insurance	Pooling
Mismatch Risk	3	2	1	1
Market Failure	3	1	1	1
Benefit Efficiency	3	2	1	1
Risk transfer - Friction of recycled premium	3		1	1
Simplicity	1	3		2
Lock In - inability to change	3	2	1	1
Cultural Fit with Trustee	3		1	1
Claims Management Improvements	3		1	1
Master of own destiny	3	2	1	1

Alternative Structures

Attribute	Typical Current	Alternatives that modify current structures						Alternatives that introduce structures not currently used		
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence	Derivatives	Self Insurance	Pooling
Mismatch Risk	3	2				2	1	2	1	1
Market Failure	3	2	1	2		2	1	1	1	1
Benefit Efficiency	3		2	2	1	2	2	2	1	1
Risk transfer - Friction of recycled premium	3				1		2		1	1
Simplicity	1	2	2		2					2
Lock In - inability to change	3	2			2		1	2	1	1
Cultural Fit with Trustee	3			2		2	1		1	1
Claims Management Improvements	3			2		2	1		1	1
Master of own destiny	3	2	2	2		2	1	2	1	1

End

End

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Other

APRA mission: To establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive financial system.

Other

Inappropriate erosion

“...to only offer or acquire insurance of a particular kind, or at a particular level, if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries”.



Other

Moody's Rating	Number of Companies	Credit Risk
Aa2	2	Very low
Aa3	1	Very low
A1	1	Low
A2	1	Low
A3	2	Low
Baa1	4	Moderate
Baa2	5	Moderate
Baa3	2	Moderate
Ba1	1	Substantial
Ba2	1	Substantial
B1	1	High